Internal Revenue Service

memorandum

CC:EBEO:Br4
MJRoach

date: JUL 10 1995

to: Director, Exempt Organizations Division CP:E:EO
Attn: Robert Fontenrose

from: Chief, Branch 4 CC:EBEO:Br4
Associate Chief Counsel (Employee Benefits and Exempt Organizations)

subject: [redacted]

This memorandum responds to your request dated June 14, 1993, for our comments on whether the subject organization, established to provide medical insurance benefits and other welfare benefits to employees of unrelated employers, qualifies as a voluntary employees' beneficiary association (VEBA) exempt from income tax under section 501(c)(9) of the Internal Revenue Code. The employers and an organization claiming to be a union have signed an agreement that purports to be a collective bargaining agreement, but the agreement appears to cover primarily or exclusively participation in the welfare benefit fund and other benefit programs offered through the alleged union.

FACTS

The [redacted] (the "Taxpayer"), represents in its responses to the questions on Form 1024 and in its subsequent correspondence with you that it is a "collectively bargained multiple employer welfare benefit fund." According to Taxpayer's representations, it is sponsored by the [redacted], a non-profit labor organization that has registered with the Department of Labor as a labor union and has received a determination letter from the Internal Revenue Service recognizing its status as a tax-exempt labor organization under section 501(c)(5) of the Code. (Letter dated August 12, 1992, from [redacted], Trustee, to James L. Joseph, Tax Law Specialist, Exempt Organizations Ruling Branch 1, Ex. 12.) The [redacted] asserts that it has been recognized as the representative of the employees in a substantial number of bargaining units, either by voluntary recognition on the part of the employers involved after a "card check", or after a representation election conducted by the National Labor Relations Board. Taxpayer has provided copies of two certifications by the NLRB appointing the [redacted] as the exclusive representative of the employees in a particular bargaining unit. (Letter from [redacted] Trustee, to James L. Joseph, Ex. 2.) However, neither of the employers named on these certifications appears on the list of employers participating in Taxpayer's program, as furnished to you in response to your inquiries about the apparent incompleteness of a prior list of employers. (Letter from [redacted] Trustee, to James L. Joseph, page 5, and Ex. 4.)

Taxpayer has provided documentary support tending to show that its sponsoring labor organization was designed to enable the clerical and support staff employees of small to medium size businesses to organize. The Preamble to the Constitution and Bylaws of the [redacted] (which is attached as Ex. 8 to the letter from [redacted] cited above) states that the goal of the Association is to provide effective representation to employees in commercial, office and professional establishments, without the "hostility or militancy" often associated with collective bargaining negotiations. Taxpayer has also provided copies of pattern bargaining agreements that set forth the general terms of a collective bargaining agreement, including the management rights clause, the "no strike, no lockout" clause, the union recognition clause, and an arbitration clause. The two pattern agreements provided were each for a one-year term, beginning on [redacted], and [redacted] respectively. The clauses of the two agreements were almost identical, but the [redacted] agreement did include a minimum wage scale that had been lacking in the [redacted] agreement. ([redacted] letter, Exs. 5 and 5A.)

The pattern agreements entered into by the [redacted] state that the employers were being represented in the collective bargaining negotiations by the [redacted] an employers' association that appears to have been established specifically to negotiate with the [redacted] Taxpayer has included a sample application that a prospective employer would use to join the [redacted] ([redacted] letter, Ex. 6.) The sample application is on a printed form and includes a ratification of the [redacted], collective bargaining agreement with the [redacted] On the back of the form is a schedule of "employer benefits" that the applicant is asked to complete to check off the benefits that it desires to provide for its employees. The list of benefits available includes, of course, the group health plan that is the subject of this application. It also includes a death benefit plan, a group dental plan, a disability plan, a medical reimbursement plan, a dependent care plan, a qualified retirement plan, and "other benefits." ([redacted] letter, Ex. 6.)

In two instances, Taxpayer has offered the right to participate in its program to groups of employees whose rights arise under the terms of a collective bargaining agreement entered into by a different, and apparently unrelated, union. In one of these cases, the [redacted] negotiated a collective bargaining agreement with certain [redacted] school systems on behalf of a "residual" bargaining unit consisting of part-time school system employees not eligible to participate in the principal unit of full-time employees represented by the [redacted] One of the provisions of this collective bargaining agreement was that the bargaining unit employees were eligible to participate in the [redacted] as an "alternative health care program different from that offered only to full-time employees." (Letter from [redacted] and [redacted]

[redacted] to Gerald V. Sack, dated January 28, 1993, at page 9.)

Taxpayer's counsel offers the following justification for the inclusion of the [redacted] bargaining unit members in the [redacted] letter dated January 28, 1993, at page 9):

> These "part-time" employees are a residual bargaining unit (i.e. those employees not in the principal unit of full-time employees) who are entitled to their own health care program pursuant to a written supplement to that basic collective agreement. Their collective bargaining representative has negotiated with their employer so that a management-union trust program sponsored by another labor organization can provide the protection for the [redacted] part-time employees in a manner not unlike any other joint labor agreement for a group of units at the same facility. For example, the [redacted] are participants in the [redacted] Many [redacted] building and construction trades groups band together for a single health care fund which will include numerous different unions such as carpenters, plumbers, painters, and laborers, again because no one union has the size and depth to provide the benefits they all want to provide their members.

After Taxpayer's application was transferred to you by the Key District Office, taxpayer's counsel provided documentation concerning a second instance of participation in its program by members of a bargaining unit represented by a union other than the [redacted] (Letter dated July 20, 1993, from [redacted] to James L. Joseph of Exempt Organizations Rulings Branch 4, and attached exhibits.) In this instance, the [redacted] included a provision in two collective bargaining agreements with [redacted] offering participation in the [redacted] as a "new Company medical plan" in place of the existing plan sponsored by [redacted] The agreements in question covered production workers and craft workers, respectively, at the [redacted] Under the terms of the medical plan clause of each agreement (at page [redacted] of the production agreement and at page [redacted] of the craft agreement) the existing Company plan was closed to new entrants after [redacted] and new employees in the bargaining unit were offered the choice of participation in the [redacted] involved in this case or in an HMO for their medical coverage. These agreements were entered into on [redacted] and were provided to you under cover of the letter from [redacted] cited above.

The trust instrument under which Taxpayer is operated contains a number of provisions that show that it was intended to qualify as a "Taft-Hartley" trust under section 302(c) of the Labor-Management Relations Act of 1947. There are two union trustees and two management trustees, with provision for the [redacted] (the "Union") and the [redacted] (the "Employer") to designate the Union Trustees and the Employer Trustees, respectively. (Declaration of Trust, dated [redacted] attached as Ex. 5 to the letter dated April 28, 1992, from [redacted] Trustees, to Conrad Rosenberg, Chief, Exempt Organizations Rulings Branch 1, at pages 8-9. (Cited hereafter as "Declaration of Trust.")) The Board of Trustees is given the authority to enforce the payment of contributions from participating employers. (Declaration of Trust, supra, at pages [redacted]) The Board is also given the authority to examine the payroll and employment records of any participating employer to the extent necessary to enable the Board to determine the contributions due from that employer under the terms of its collective bargaining agreement and to enable the plan administrator to determine the validity of claims presented by employees of that employer. (Declaration of Trust, supra, at pages [redacted])

Taxpayer's trust instrument authorizes the Board of Trustees to negotiate with other unions to accept members of their bargaining units as participants in the fund. This may be done through the merger or consolidation of the fund with another welfare trust fund or through a joint participation agreement. (Declaration of Trust, supra, at pages [redacted] and [redacted]) The file contains a copy of the agreement under which the [redacted] bargaining unit members were permitted to participate in the fund. (Letter dated April 28, 1992, to Conrad Rosenberg, supra, Ex. 6.) This agreement was entered into by the [redacted] and the [redacted] and it was signed by their representatives. It was not signed or witnessed on behalf of Taxpayer.

The exhibits to Taxpayer's Form 1024 also contain a document entitled [redacted] (Form 1024, Ex.4.) This document describes Taxpayer as the plan sponsor. Any person satisfying the requirements for participation in Taxpayer's group medical plan is eligible to participate in this cafeteria plan. Under the cafeteria plan, each participant's employer "redirects" a portion of the compensation otherwise payable to that participant to the plan. The summary plan description of the cafeteria plan asserts that each participant may then use the contributions made to the plan to pay for health care reimbursement, dependent care assistance, or health care contributions on a pre-tax basis. (Form 1024, Ex. 4, at pages 2, 4-5.) The plan document for the cafeteria plan states that the term "sponsor" means Taxpayer, and the term "employer" means any employer that has ratified a collective bargaining agreement with the [redacted] or has entered into an agreement, either directly or through the bargaining

representative of its employees, to provide benefits through Taxpayer. (Form 1024, Ex. 2, at pages 2-3.)

ANALYSIS

The purported VEBA established by Taxpayer in this case does not appear to qualify for exemption under section 501(c)(9) of the Internal Revenue Code because the participants here do not share an "employment related common bond" as required by §1.501(c)(9)-2(a) of the Treasury Regulations. So far as appears from the documents in the file, this arrangement is not the result of genuine collective bargaining, but rather is a masquerade designed to allow the promoters to provide medical insurance to unrelated persons scattered throughout the country while avoiding the tax and regulatory burdens imposed on the operation of an insurance company. Although the presence or absence of bona fide collective bargaining is a question of facts and circumstances and is difficult to evaluate based on the review of documents in an application file, the presence of two fairly large groups of employees from different parts of the country ([redacted] and [redacted] respectively), represented by unions unrelated to the [redacted] tends to show that this program is basically a device for the sale of health insurance to unrelated groups of individuals, not a union-sponsored medical plan. It may be appropriate to offer Taxpayer's representatives an opportunity to show that the decisions of employers to enter into this arrangement have been the result of bona fide negotiations with employee representatives.

Taxpayer's representatives, in the January 28, 1993, letter quoted above, have argued that Taxpayer's arrangements with the [redacted] and with the [redacted] represent a common, and unobjectionable, method of providing affordable health care coverage to members of small bargaining units. Taxpayer's contention is that allowing the members of a bargaining unit represented by one union to bargain for coverage under a multiemployer welfare benefit fund sponsored by another union is in the best interests both of the unions and of the employees they represent, because it allows the consolidation of bargaining units into a large enough group of participants to take advantage of economies of scale and to spread the risk of adverse experience over a large enough number of covered employees to minimize the chance that a few costly illnesses among the members of the group will increase premiums to unacceptable levels.

Although economic considerations may support the creation of a welfare benefit fund covering employees represented by more than one labor union, these considerations have no effect on the legal standard for recognition of an exemption under section 501(c)(9), namely, the requirement of §1.501(c)(9)-2(a)(1) of the Treasury Regulations that the members of the organization seeking exemption must have an employment-related common bond. Under the regulations, this requirement will be satisfied if an applicant for recognition

of an exemption under section 501(c)(9) can show that the participants in its program are entitled to membership in the organization "by reason of one or more collective bargaining agreements." The regulation does not state any criteria for determining whether the members of an association are entitled to participate "by reason" of a collective bargaining agreement. However, temporary regulations defining an analogous phrase have been promulgated under section 419A(f)(5) of the Code. That section provides an exemption from the limits of section 419A for a separate welfare benefit fund maintained "under a collective bargaining agreement." Section 1.419A-2T, Q & A 2(2) of the Temporary Treasury Regulations states that "a welfare benefit fund is considered to be maintained pursuant to a collective bargaining agreement only if the benefits provided through the fund were the subject of arms-length negotiations between employee representatives and one or more employers...." This standard appears to be a suitable basis for interpreting the membership requirement of Treas. Reg. §1.501(c)(9)-2(a)(1). Only if the organization can show that the collective bargaining agreements on which it relies have been reached after bona fide bargaining between employers and employee representatives over the benefits to be provided will the participants be deemed to be entitled to membership in the organization "by reason of one or more collective bargaining agreements."

It is a common practice in the building and construction trades to establish a single health care trust fund covering the members of different unions working on the same project or working for the same contractors on projects in the same general area. On occasion, unions will negotiate with employers to allow the employees they represent to participate in a welfare benefit fund sponsored by a different union that represents other employees at the same plant. Neither of these practices, both of which are discussed by Taxpayer's representatives, supports Taxpayer's inclusion of the bargaining units from [redacted] and [redacted] as described above, in its fund.

In this case, the members of the bargaining units represented by unions other than the [redacted] appear to have no ties to the members of the bargaining units represented by the [redacted] other than the desire to purchase medical insurance at a group rate. By contrast, in a typical situation involving inter-union cooperation in establishing a health care fund, the different unions negotiating for employer contributions to a single health care fund usually represent employees working at the same plant or on the same job site, but in different occupational classifications. In the special case of the building and construction trades, equitable considerations, as well as longstanding industry practice, have resulted in cooperative efforts by a number of trade unions to establish welfare benefit funds covering employees in different trades working for unrelated employers. In the absence of such inter-union cooperation in these trades, the unions involved would be unable to achieve the economies of scale and the continuity of

coverage necessary to offer a workable health benefit program to the employees they represent.

In providing welfare benefits to workers at the same plant, on the same job site, or in an industry characterized by fragmentation of job classifications and short-term employment, such as the building and construction trades, considerations of efficiency and employee morale suggest that both the employers and the unions representing the employees have an interest in making the same benefit package available to everyone. Experience has shown that, in these situations, the existence of a welfare benefit fund covering employees represented by several different unions does not detract from the incentive for both employers and employee representatives to bargain in good faith over the benefits to be provided to the members of each bargaining unit. No similar considerations support Taxpayer's inclusion of part-time school employees in [redacted] in the same fund with office and professional employees in [redacted] Unless Taxpayer can show that the inclusion of these groups, as well as the inclusion of the employees purportedly represented by the [redacted] was supported in each case by bona fide bargaining between employers and employee representatives, the application in this case should be denied.

Although it appears that the purported "cafeteria plan" included as part of Taxpayer's package of benefits is not a valid cafeteria plan within the meaning of section 125 of the Internal Revenue Code because Taxpayer is not the employer of the participants in the plan, the Internal Revenue Service has issued a "no rule" position with respect to cafeteria plans and the benefits offered under cafeteria plans in section 8.07 of Rev. Proc. 94-4, 1994-1 I.R.B. 90, 100 and section 3.07 of Rev. Proc. 94-1, 1994-1 I.R.B. 79, 80. [redacted]

this would be an additional ground for denial of the application, because a VEBA may not provide retirement benefits. Treas. Reg. § 1.501(c)(9)-3(f). However, there is no explicit support in the file for the assertion that Taxpayer, rather than some other fund established by the [redacted] and the employers participating in Taxpayer's welfare benefit program, is providing retirement benefits. [redacted] However, the narrative description in the answer to Question 1, Part II, of Form 1024 states that Taxpayer is a "collectively bargained multiple employer welfare benefit fund" designed to provide flexible benefits to the employees of the employers contributing to it pursuant to the terms of various collective bargaining agreements negotiated by the [redacted] a non profit labor

organization. The description goes on to say: "Benefits that may be negotiated for on behalf of the employees include: (1) a death benefit plan; (2) health insurance plans; (3) a group dental plan; (4) a disability income plan; (5) a dependent care plan; (6) a medical reimbursement plan; and (7) certain qualified retirement plans."

Although the language in Taxpayer's reply to Question 1 of Part II of Form 1024 could have been more artfully drafted, it seems probable that the intent of the answer was to say that the [redacted] could negotiate for qualified retirement benefits on behalf of the employees that it represents, not that those retirement benefits would be provided through Taxpayer, a welfare benefit fund. Labor unions, of course, can and do negotiate for retirement benefits for the members of the bargaining units they represent. Such benefits are often provided through a Taft-Hartley pension trust.

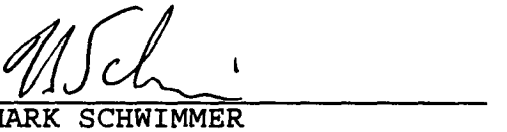
There is no indication in the file that Taxpayer, which was designed as a welfare benefit fund, was improperly set up to include pension benefits. On the contrary, Taxpayer's Declaration of Trust describes it as a "welfare trust fund" and provides an elaborate recitation of the trustees' authority to provide health, welfare, and related benefits, but makes no mention of pension benefits. (Declaration of Trust, supra, preamble and Article [redacted]) Given the specific limitations in the language of the trust instrument, it is unlikely that the drafter of that instrument made the elementary, and fatal, mistake of including pension benefits in a welfare benefit fund. Similarly, the listing of a qualified retirement plan on the "Schedule of Employer Benefits" on the back side of the Application for Membership in the [redacted] does not, standing alone, show that these retirement benefits were to be provided through Taxpayer, a welfare benefit fund. (Letter from [redacted] Trustee, [redacted] dated August 12, 1992, Ex. 6.) The Application for Membership refers to the terms of the current collective bargaining agreement established by the [redacted] not to the provision of specific benefits through Taxpayer. [redacted]

In short, there are substantial reasons to doubt that the program offered by Taxpayer in this case is offered only to participants who are entitled to membership in Taxpayer "by reason of one or more collective bargaining agreements." In the absence of further evidence to show that the purported collective bargaining agreements on which Taxpayer relies were the result of bona fide

bargaining between employers and employee representatives, the application in this case should be denied.

CONCLUSION

The members of an association providing welfare benefits to its members must share an employment-related common bond in order for the association to qualify for exemption under section 501(c)(9) of the Internal Revenue Code. Under the regulations, an association qualifies for exemption under section 501(c)(9) if membership in the association is open to employees in specified job classifications, working for certain employers at specified locations, and who are entitled to benefits by reason of one or more collective bargaining agreements. Whether the members of a group of individuals forming an association share an employment-related common bond is a question to be determined with regard to all the facts and circumstances. If the association claims to qualify as a multiemployer collectively bargained VEBA, the facts and circumstances must show the existence of bona fide bargaining between employee representatives and employers or their representatives. The association in this case shows little evidence of bona fide bargaining. The circumstances under which employees have joined the purported labor union sponsoring the association and under which representatives of that union solicit and obtain employer agreements to contribute to the trust through which the benefits are funded tend to show that the association is designed primarily as a vehicle for the sale of insurance. Accordingly, unless further development of the facts demonstrates to your satisfaction that the union in this case has engaged in bona fide bargaining on behalf of the members of the association, the association is not exempt under section 501(c)(9) of the Code.



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